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NO. 72-1544

IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

H. L. H. ENTERPRISES, INC., ET AL., *Petitioners*

v.

A. W. MCGREGOR and KERVIN E. JACOB, *Respondents*

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

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OPINIONS BELOW

The proceedings in the district court are not reported. The per curiam opinion of the Court of Appeals is reported at 470 F.2d 188.

JURISDICTION

The per curiam judgment of the Court of Appeals was entered on December 12, 1972. A petition for rehearing

filed by petitioners was denied February 21, 1973. A petition for rehearing filed by an appellant (J. W. Rooks) in the Fifth Circuit not joining in this Petition was untimely filed and was denied.

The money judgment in favor of respondents entered by the District Court as amended by the Court of Appeals has been paid by the petitioners.

The petition for a writ of certiorari was filed on May 17, 1973. The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254.

QUESTIONS PRESENTED

Petitioners assert that six questions are raised by this petition. The questions listed by petitioners are so general as to be meaningless. Respondents assert no questions worthy of a writ of certiorari are involved in this case. Respondents will reply, point by point, to the issues raised in petitioners' argument.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutory and regulatory provisions are set forth in the Appendix to the petition. (Pet. App. 30-31.)

STATEMENT

One defendant-appellant below, who is not before this Court and against whom the judgment is final, is J. W. Rooks. Rooks and respondents were the sole shareholders of Fast Foods Incorporated, a Texas corporation, a company which was engaged in the fast foods business. Following various sales and purchases among Rooks and the respondents, the ownership of Fast Foods stock on March 20, 1969 was 52% in Rooks and 24% in each

respondent. (Pet. 3-4.) Until March 20, 1969, respondents believed, in reliance upon Rooks who was President of the company and was managing the fast foods units, that the corporation was making good progress. The progress was reflected in a letter from Rooks to the respondents dated January 23, 1969. (App. 94-95.)*

On March 20, 1969, the board of directors met in emergency session called by Rooks. Rooks stated that the corporation was in severe financial straits due to operating losses, that it was impossible to continue operations, and that the only alternative was to sell or raise additional capital. (Pet. 8-9.) This was the first knowledge respondents had that anything allegedly was amiss with the corporation.

At the meeting of March 20, 1969, Rooks told respondents that he, Rooks, already had been in contact with petitioner Chambers, president of petitioner H.L.H. Enterprises. Rooks stated Chambers was willing to pay $20 per share for all the stock of Fast Foods, Inc. After a day long session, the meeting was adjourned. (Pet. 9.)

A second meeting of Rooks and respondents (being the Board of Directors of Fast Foods) was held on March 22, 1969. Rooks divulged for the first time, that he had written checks totaling $25,000 to pay outstanding bills, that the checks were hot, and that petitioner Chambers was ready to write a check for $25,000 to cover those checks. Other alternatives were discussed, but Rooks was not agreeable to anything except the sale of the business. Rooks recommended respondents sell their corporate stock to Chambers, acting for H.L.H. Enterprises, Inc., which company would actually purchase the stock. (Pet. 9-10.)

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* "App." refers to the printed Appendix in No. 72-1245 in the United States Court of Appeals for the Fifth Circuit.

This same day Chambers was contacted by telephone and came to the meeting of Rooks and respondents. Chambers offered $20 per share for the stock and an assumption of all debts of Fast Foods, Incorporated. Chambers left the meeting. (Pet. 10.)

Rooks' services in running the company were essential, as respondents (McGregor, a minister, and Jacob, a commercial egg producer) had no ability to do so. Rooks refused to continue. Because respondents personally could not run the business and because of the pressure put on respondents by Rooks to sell, respondents decided to sell out to H.L.H. Enterprises.

The respondents, after making the decision to sell, and still believing that the business was worth more than Chambers had offered, made a counter-offer by telephone to sell the stock for $30 a share and assumption of liabilities. This was immediately accepted by Chambers, on behalf of H.L.H. Enterprises, Inc. (Pet. 10.)

The terms of the actual contract for the purchase and sale of respondents' stock together with other documentation securing the terms of the conveyance, were negotiated by attorneys for each party, and after revisions (App. 124-127.), the stock was sold and conveyed to petitioner H.L.H. Enterprises, Inc. on March 27, 1969. The U. S. mails were used to deliver this executed contract to respondent McGregor. (App. 106-107.)

Unknown to respondents at that time (App. 150-152.), by instruments dated March 25, 1969, which was two days prior to the actual sale and purchase of respondents' stock, Rooks had obtained a written contract from H.L.H. Enterprises, whereby he would be paid an additional $90,000 over five years. This contract was secured by the

execution and delivery to Rooks of a promissory note payable to his order; the maker of the note was H.L.H. Enterprises, Inc., and it was signed by Harry L. Chambers on behalf of the corporation. (App. 100-101.)

Rooks represented to respondents that Chambers, acting for H.L.H. Enterprises, had offered him a job at the same salary Rooks had been making, and that he would be working as a consultant for H.L.H. Enterprises, Inc. for a period of two years at that salary ($1,500 monthly). (App. 102-103, 150-151, 181-183.) These representations were made to respondents by Rooks personally. Respondents did not know and were not told by Rooks, Chambers or anyone else, that instead of a job for $1,500 per month for two years, Rooks was actually receiving, and had obtained for himself two days prior to respondents' sale of their Fast Foods stock, a $90,000 note payable over five years. (App. 102-103.)

Respondents had no knowledge of this transaction between Rooks and H.L.H. Enterprises until the fall of 1969 when McGregor found out that Rooks had moved to Atlanta, Georgia, and was working full time for a totally unrelated fast food company. (App. 103-104, 152.) Chambers revealed to respondent McGregor that there was a five year promissory note payable by H.L.H. Enterprises to Rooks in the principal amount of $90,000. (App. 103-105.) Chambers admitted to McGregor that Rooks was not and had not worked for H.L.H. Enterprises. Chambers told McGregor that the agreement between H.L.H. Enterprises and Rooks could not be broken; Chambers suggested to McGregor that Rooks be contacted and asked to share with McGregor and Jacob their portion of that $90,000. (App. 104-105.)

Following Chambers' advice, McGregor did make a long distance interstate telephone call to Rooks and Rooks admitted receiving the $90,000 note; he stated that he worked harder in the business than the respondents had and that he deserved more out of it and advised respondents it was not their affair. (App. 105-106.)

It is clear and uncontested in the record that respondents would not have sold their stock to H.L.H. Enterprises, Inc. for the consideration they received, if they had known about the extra $90,000 received by Rooks. (App. 107, 152.)

ARGUMENT

The decision below is correct. There is no conflict. The only issues involved were factual ones which were resolved against petitioners by the jury. There is no reason for further review.

1. Section 10(b) of the Securities and Exchange Act of 1934, and Rule 10b-5, ban the use of any deceptive device in the purchase or sale of any security by any person. The transaction need not be through an exchange or in over-the-counter markets. *Superintendent of Insurance v. Bankers Life and Casualty Co.*, 404 U.S. 6 (1971); *Hooper v. Mountain States Securities Corp.*, 282 F.2d 195 (5th Cir.), *cert. denied*, 365 U.S. 814 (1961). It is uncontradicted that respondents sold all of their Fast Foods, Inc. stock to H.L.H. Enterprises, which was represented by its president, petitioner Chambers. Upon uncontested evidence, the jury in the district court found a deceptive device used in the sale of respondents' securities. The arguments concerning issues of law in petitioners' point one have been laid to rest by the decision in *Super-*

intendent of Insurance, supra. The decision below is correct.

2. The respondents agreed on March 22, 1969, to sell their Fast Foods stock to H.L.H. Enterprises. The transaction was not reduced to writing and closed until March 27, 1969. Petitioners argue that the sale was concluded on March 22, 1969. How strange. No agreement was signed nor certificates transferred nor cash exchanged that day; the sale was closed on March 27, 1969. Petitioners conveniently ignore the fact that the oral agreement for the sale of the securities was not binding and enforceable until reduced to writing, signed by all parties and delivered. As the contract for the sale of securities included the assumption of several long-term, multiple year leases and long-term installment purchases of equipment (over one year), the agreement could not be enforced unless and until it was reduced to writing and executed by the parties.

A glowing financial report on Fast Foods, prepared by Rooks, was mailed by him to respondents on January 23, 1969. Telephone conversations were used by Rooks to call meetings and to initiate the scheme to defraud respondents. Telephone communications were instrumental in consummating the fraud, for Rooks called Chambers to the meeting of March 22, 1969 and introduced him to respondents. Respondent McGregor received by mail the executed contract of sale of the stock, dated March 27, 1969. The envelope used to mail that contract was introduced in evidence. Other use of the mails as part of the fraudulent scheme included Rooks mailing $25,000 in hot checks; this act was part of the successful scheme to pressure the respondents into selling out.

It is clear and undisputed that petitioners used, and caused to be used, telephone communications (an instru-

mentality of interstate commerce) and used the United States mails as a part of their scheme. Therefore, petitioners participated in interstate commerce and used the mails in a manner sufficient to bring this cause of action within Section 10(b) and Rule 10b-5. *Hooper v. Mountain States Securities Corp.*, 282 F.2d 195, 204-205 (5th Cir.), *cert. denied*, 365 U.S. 814 (1961); *Matheson v. Armbrust*, 284 F.2d 670, 673 (9th Cir.), *cert. denied* 365 U.S. 870 (1961); *Myzell v. Fields*, 386 F.2d 718, 727-728 (8th Cir.), *cert. denied* 390 U.S. 951 (1968); *Ingraffia v. Belle Meade Hospital, Inc.*, 319 F. Supp. 537, 538 (E.D. La. 1970); *Nemitz v. Cunny*, 221 F. Supp. 571, 573 (N.D. Ill. 1963); and see 2 A. BROMBERG, SECURITIES LAW: FRAUD, §11.2 at p. 245 (1968).

3. Respondents testified at trial in the district court; petitioners did not. The testimony and the exhibits in this case are totally uncontradicted. Neither the district court nor the jury nor the Court of Appeals were persuaded by the petitioners' arguments on the interpretation of facts. Those very same arguments are renewed here without adding anything meriting further review.

The direct and circumstantial evidence established that petitioners and Rooks had been secretly negotiating with Chambers prior to the time Rooks called respondents to the "emergency" meeting to discuss the so-called desperate financial condition of the company. The secret Rooks-Chambers negotiations were the active beginning of the scheme and artifice to defraud respondents, although the circumstantial evidence suggests that the scheme began earlier when Rooks induced the respondents to surrender controlling stock ownership to him. Rooks pressured, coerced and induced respondents in the direction of selling

their stock to H.L.H. Enterprises, Inc. Rooks never disclosed that he had any relationship with Chambers or H.L.H. Enterprises until after *McGregor* asked him about his future employment at which time Rooks falsely represented that he had a job for two years, which was not the truth, as he received a secret premium for his stock.

The scheme, device or artifice to defraud, in essence was: (1) the petitioners establishing and having the secret business and financial relationship between themselves concerning this corporation; (2) calling the respondents to an emergency meeting and unsuccessfully attempting to induce them to sell to H.L.H. Enterprises. Inc.; (3) issuing $25,000 in hot checks to force a decision; (4) having Chambers and H.L.H. Enterprises, Inc. appear to be rescuing Fast Foods through a "generous" offer to purchase stock and assume liabilities; and (5) applying relentless pressure to induce respondents to sell, by vetoing all other alternatives, which were available. It is also significant in this regard that when respondents relented and decided they would sell, Chambers immediately accepted their counteroffer. It is not difficult to understand why the jury found that there was a device, scheme and artifice to defraud the respondents and that Rooks and petitioners were parties to it.

Rooks made a false statement of a material fact by stating to McGregor that he had a job with H.L.H. Enterprises, Inc. for two years at the same salary he was then making. The statement was untrue, as Rooks had obtained a secret $90,000 premium in addition to the disclosed consideration which purportedly was exactly the same as that received by respondents. Any reasonable person would be lulled into a sense of security by a reasonably appearing statement such as the one Rooks made to respondents.

In this regard, it must be noted that Rooks was a member of Reverend McGregor's congregation and that respondents trusted Rooks and believed him to be honest.

That the affirmative statement Rooks made was false and untrue is proved as follows: (a) Rooks did not work for H.L.H. Enterprises, Inc., but instead moved to Atlanta, Georgia, and worked for an unrelated company; (b) Rooks, in fact, had additional $90,000 in his pocket in the form of a promissory note payable over five years for no work on his part. Obviously, this was a sham and a subterfuge, as the jury correctly found in its verdict. Had there been a genuine employment contract, Rooks breached it, and H.L.H. Enterprises would not have been bound to continue paying as it did.

There is no question but that respondents were entitled to full disclosure of the $90,000 premium that Rooks received from Chambers as president of H.L.H. Enterprises. It should be noted that respondents made the inquiry about whether or not Rooks would have a job with Chambers and H.L.H. Enterprises following the sale; Rooks did not volunteer any information about his future until the inquiry was made. Thus, respondents showed diligence in making the inquiry and did not display any lack of due diligence as sellers of securities. Having made the appropriate inquiry, the false and misleading answer appeared to be an entirely reasonable and satisfactory one, and was not one that would have led any reasonable person to make further inquiry under the circumstances.

Respondents met their burden of proof. There was a scheme and device to defraud; a false misstatement on a material fact; a fraudulent withholding of a material fact.

No further review is warranted by petitioners arguments. The facts were found against petitioners. *Affiliated Ute Citizens v. United States,* 92 S.Ct. 1456, 1471-1472 (1972); *Rogen v. Ilikon Corp.,* 361 F.2d 260 (1st Cir. 1966); *Schine v. Schine,* 250 F.Supp. 822, 874 (S.D.N.Y. 1966); and *Bredehoft v. Cornell,* 260 F.Supp. 557 (D. Ore. 1966).

5. This case was tried and submitted on the theory that the $90,000 was additional consideration going to Rooks as a result of the scheme entered into by Rooks and Chambers. On the uncontested facts presented to the district court and jury, the only real issue as to damages was a determination as to what portion of the $90,000 should be awarded to respondents. Indeed, there being no real issue of fact here, the trial court could have awarded appropriate damages as a matter of law.

A defrauded seller of securities is permitted, under Section 10(b) and Rule 10b-5, to recover the differences between the actual value of the securities sold and what he has received at the time of the sale. *Affiliated Ute Citizens v. United States,* 92 S.Ct. 1456, 1473 (1972); *Myzell v. Fields,* 386 F.2d 718, 744-745 (8th Cir.), *cert. denied,* 390 U.S. 951 (1968); *Janigan v. Taylor,* 344 F.2d 781, 786 (1st Cir.), *cert. denied,* 382 U.S. 879 (1965). Since the stock of Fast Foods was never traded on any market, its value was fixed by the consideration H.L.H. Enterprises, a willing, indeed an eager buyer, paid for it—$120,000 ($30,000 known to respondents plus a secret $90,000), or $120 per share. *Affiliated Ute Citizens, supra; Myzell v. Fields, supra;* and *Janigan v. Taylor, supra.*

Petitioners insist the jury should have been instructed on some complicated mathematical formula. However, the

true value was fixed by a sale; petitioners admit the value of the Fast Foods stock on March 27, 1969, was what a purchaser was willing to pay for it. There was a purchaser, H.L.H. Enterprises; that purchaser paid $120,000 ($30,000 known to respondents and $90,000 unknown) for the acquisition. Accordingly, the respondents were injured to the extent that they did not receive full value for their stock upon the sale.

In reading the instructions of the district court as a whole which must be done upon any appeal, it is seen that the jury was properly instructed on the measure of damages. Under the uncontested facts before the jury, there was no need for the district court to give the jury a lecture on abstract theories of the law of damages. This was a simple case involving less than one day's testimony of two witnesses. The facts and figures are simple and clearly undisputed. The charge on measure of damages was proper. Indeed, damages could have been directed as a matter of law.

6. Point 6 of petitioners' Argument presents a number of contentions dealing with the questions of materiality and representations made by petitioners, and with the duty petitioners had to disclose information. This case is not one where an insider did not disclose information to other insiders, who could have ascertained for themselves the correct information upon examining books and records to which they had access. No amount of study of the books and records of Fast Foods by respondents would have revealed the side deal that Rooks and Chambers (on behalf of H.L.H. Enterprises) made in connection with the purchase and sale of the Fast Foods stock. In fact, even if respondents had had access to the books and records of H.L.H Enterprises, they would not have

discovered the existence of Rooks' additional, secret consideration of $90,000 upon the sale of his stock to H.L.H. Enterprises. (See Plaintiffs' Exhibit 5, the H.L.H Enterprises, Inc. minutes of April 3, 1969, which were not prepared until over a month after the side deal was made, and which conceal the details of the "side deal.")

There is no question but that respondents were entitled to full disclosure of the $90,000 premium Rooks received for his Fast Foods stock from Chambers and H.L.H. Enterprises. Respondents made the inquiry about Rooks having a job with Chambers and H.L.H. Enterprises following the sale of the stock; Rooks did not volunteer any information about his future until the inquiry was made. Thus, respondents showed diligence in making the inquiry and did not display any lack of due diligence as sellers of securities. Having made the appropriate inquiry, the false and misleading answer appeared to be an entirely reasonable and satisfactory one, and was not one that would have led any reasonable person to make further inquiry under the circumstances. Accordingly the misrepresentations and nondisclosures on the part of the petitioners were not, and could not be, the result of any lack of due diligence by the respondents.

The petitioners conducted a course of business and a scheme, artifice and device, that operated as a fraud upon respondents McGregor and Jacob. This occurred by petitioners' and Rooks' false statements and nondisclosure to respondents of material facts which influenced their decision to sell. McGregor and Jacob "suffered an injury as a result of deceptive practices touching [their] sale of securities . . ." *Superintendent of Insurance, supra,* at 92 S. Ct. 165; and *Affiliated Ute Citizens, supra,* 92 S.Ct. at 1472.

7. Concerning judgment against H.L.H. Enterprises, Inc., as stated by the Court of Appeals in this cause, the respondents took a cross-appeal ". . . from the unexplained act of the trial court in dismissing H.L.H. Enterprises, Inc. from the case, after the jury had returned a verdict against Rooks, Chambers (President of H.L.H. Enterprises, Inc.) and H.L.H. Enterprises, Inc., the purchaser of the stock. H.L.H. filed no brief in this court undertaking to support this unexplained action by the trial court. We conclude that the jury's verdict against the corporation was fully supported, and, therefore, that the trial court erred in failing to enter a judgment against the corporation." 470 F.2d 188, 189.

This judgment of the Court of Appeals is correct in that the evidence, both oral and documentary, clearly reflects that Chambers at all times pertinent thereto acted in behalf of H.L.H. Enterprises, Inc. as its agent. There is no evidence anywhere in the record to refute this. Chambers negotiated for the purchase of Fast Foods, Inc. by H.L.H. Enterprises in his capacity as President of that company. (App. 117, 118, 125, and 136.) It is further undisputed that after the negotiations were concluded between Chambers and the respondents, the attorneys for H.L.H. Enterprises, Inc. and Fast Foods, Inc. prepared the documents for the conveyance of the stock. (App. 125-126.) This Purchase Agreement (Pl. Ex. 3; App. 206-216.), plainly recites the sale of the stock of Fast Foods, Inc. to H.L.H. Enterprises, Inc. and is executed for H.L.H. Enterprises, Inc. by Harry L. Chambers in his capacity as President. The minutes of the Meeting of the Directors and Officers of H.L.H. Enterprises, Inc. of April 3, 1969 (Pl. Ex. 5) authorizes the purchase by that company of the stock of Fast Foods, Inc. Finally, the agreement be-

tween Rooks and H.L.H. Enterprises, Inc. for Rooks' additional consideration of $90,000 (Pl. Ex. 4) was executed by Harry L. Chambers in his capacity as President of that corporation. No objections were made below by petitioners to the admission of this evidence.

At no place in the record is there an assertion by petitioners or their counsel that Chambers acted otherwise than in behalf of H.L.H. Enterprises, Inc. In fact, in counsel's objections to the jury charge, Mr. Heath asserted that Chambers did act for H.L.H. Enterprises, Inc. in this transaction. (App. 196-197).

Thus, there was no issue of fact respecting Chambers' agency relationship to H.L.H. Enterprises, Inc.

The trial court correctly charged the jury on the ability of a corporation to act through its agents, officers or employees (App. 191.), and the jury found that Chambers knowingly participated with Rooks in employing a device, scheme or artifice to defraud respondents; making a false statement of a material fact, which statement or omission misled the respondents to sell their stock; and in engaging in an act, practice or course of business which operated as a fraud or deceit upon respondents.

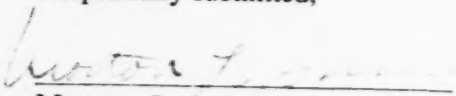
It was unnecessary for the district court to have the jury determine whether or not H.L.H. Enterprises, Inc. acted by and through its President Harry L. Chambers because the evidence in this regard was totally undisputed, and undisputed facts need not be submitted to the jury. *Eastern Air Lines v. American Cyanamid Co.*, 321 F.2d 683 (5th Cir. 1963). The court would have been justified in instructing the jury that as a matter of law and on the undisputed evidence, the acts of Chambers were attributable to H.L.H. Enterprises, Inc. It is hornbook agency

law that Chambers' participation in the fraudulent scheme renders his principal, H.L.H. Enterprises, Inc., liable, and accordingly, the trial court erred in denying judgment against H.L.H. Enterprises, Inc. This error was corrected by the Court of Appeals and no further review is warranted.

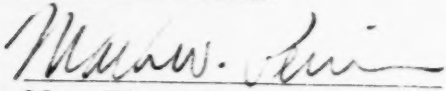
CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,



MORTON L. SUSMAN



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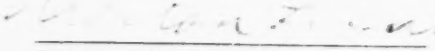
CERTIFICATE

Three copies of the above and foregoing Brief for Respondents in Opposition have been furnished to Messrs. Robert A. Heath and Robert Hyatt, 609 Colquitt, Houston, Texas 77006.



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